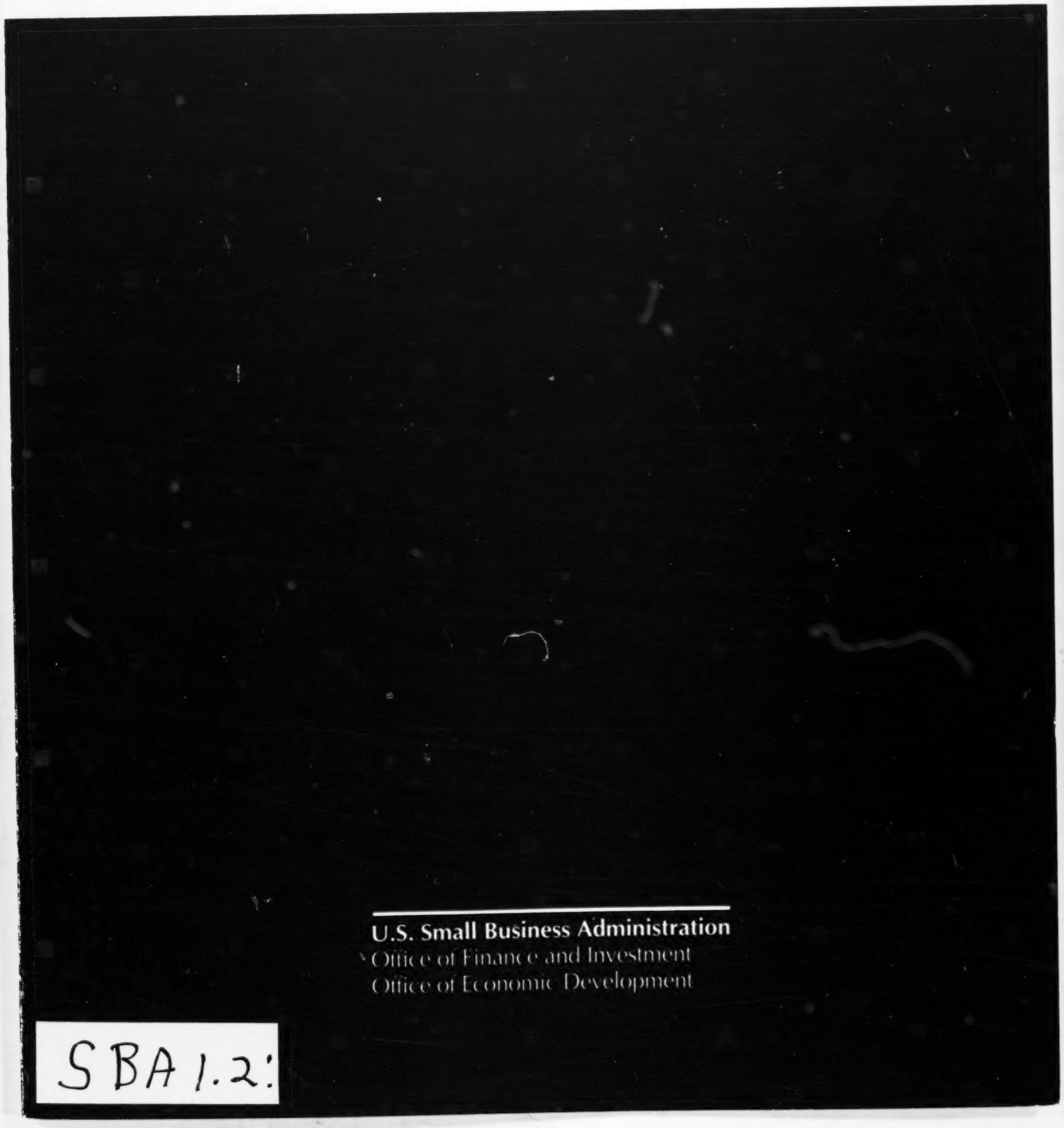
P 94/7

[redacted]

SBA: The 504 Program



U.S. Small Business Administration
Office of Finance and Investment
Office of Economic Development

SBA 1.2:

The SBA

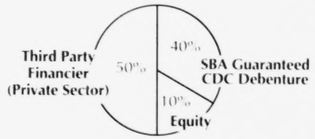
The U.S. Small Business Administration (SBA) was created to assist, counsel, and protect the interests of small business. SBA financial assistance programs provide small business owners with opportunities to use individual creativity and initiative to achieve sound business goals.

The 504 Objective

The objective of the 504 Program is to achieve community economic development through job creation and retention by providing long-term fixed asset financing to small business concerns.

The 504 Partnership

A complete 504 financial package is a combination of at least three sources: SBA, a Certified Development Company (CDC), and private sector financiers. An example of participation in 504 financing is provided below:



- The **SBA** may guarantee up to 40% or $50,000 - $750,000 in the form of a debenture to any approved project (special circumstances may allow a $25,000 debenture). The SBA debenture combined with any other federal funds may not exceed 50% of the total financing for the project.

- A **CDC** or the Small Business Concern (SBC) receiving the financial assistance is required to inject at least 10% of the total funds for any project. A CDC is an economic development entity created under the auspices of SBA to foster development in both urban and rural areas. Only CDCs may administer the 504 Program.
- **Third Party Financiers** (a bank or savings and loan institution, for example) must provide the remaining percentage of the 504 financial package (in this example, 50%).

Debentures

The SBA portion of the financing consists of a debenture — a type of bond. Debentures, pooled through a certificate mechanism, are sold publicly to investors (e.g., pension funds, insurance companies, or private individuals). Each debenture is issued in connection with the making of a loan or leasing of assets by a CDC to a SBC. Each loan must be approved by SBA. Debentures are 100% guaranteed by SBA with a "Full Faith and Credit Guarantee" issued by the U.S. Treasury. If an SBC defaults, SBA is responsible for timely payment of the debenture to the investors.

Terms

Machinery and equipment terms are 10 years and real estate terms are 20 years. Interest rates are based on current market rates for 5 and 10 year U.S. Treasury issues, plus a spread over the treasury rate based on market conditions.

Collateral

All debentures guaranteed under the 504 Program must be secured to ensure repayment. Collateral may include: a mortgage on the land and the building being financed; liens on machinery, equipment, and fixtures; lease assignments; and personal guarantees from individuals with 20 percent or more ownership in the company.

Security

The third party financier has the security of a first lien on the land and the building being financed, as well as other collateral involved. The SBA is secured by a second lien. The CDC (or SBC) holds the most junior position in the project.

Interim Financing

Loan repayment begins on the first day of the month following funding. Only a completed project can ensure the SBC of the operating capacity needed to make payments, so interim financing will be needed for all projects. The interim financier (frequently, the first mortgage lender) provides the needed capital at project start and is repaid from debenture proceeds.

Project Eligibility

The proceeds from a debenture may be used only for the purpose of assisting a SBC with fixed asset financing: plant acquisition, construction, renovation, or expansion, including the acquisition of land. Proceeds may also be used for land and site improvements (e.g., grading, streets, parking lots, utilities, or landscaping); the acquisition and installation of machinery and equipment; and the interest on interim financing. Additionally, project costs may include professional fees directly attributable and essential to the project (e.g., surveying, engineering, architectural, or legal).

Eligibility

If financing is not available from nonfederal sources on reasonable terms, an SBC must meet the following criteria to qualify for 504 assistance:

- It must be small. A business is considered small if it has 500 or fewer employees, and for purposes of 504 financing, certain manufacturing companies may have more than 500 employees based on SBA size standard regulations contained in the Federal Code of Regulations, Business Credit and Assistance edition.

(continued)

- Its net worth must not exceed $6 million and its average net income after taxes for the preceding two years must not exceed $2 million.
- It must be a for profit corporation, partnership, or proprietorship.
- It must have a "sound business" purpose.
- Its project must demonstrate a significant economic impact on the community in which it is located, primarily through job creation or retention.

Ineligibility

The following types of business are ineligible for 504 financing: nonprofit organizations; investment companies; gambling facilities; lending institutions such as banks or financing companies; and media such as newspapers, magazines, book publishers, radio, and television systems.

How to Proceed

SBCs should make appointments with loan officers from a bank and a CDC. The following documents should be prepared for any initial meeting:

- A description of the project.
- An estimate on the total project costs including estimates on new construction, renovation, machinery, or equipment.
- A purchase agreement or an offer to purchase for any real estate involved in the project.
- Product description and product literature. A SBC should be prepared to discuss its competition, the strengths and weaknesses of its product, its method of distribution, and the type of marketing it uses, future plans, and management.
- Financial statements of the company for the past three years, and an interim statement which is less than 90 days old.
- Personal financial statements of all officers and stockholders with 20% or more ownership in the company.

Contacting a CDC

Do you have questions about the 504 Program? A CDC will guide you from start to finish. To locate the nearest CDC, contact an SBA field office (refer to the government section of a telephone book under the Small Business Administration).

U.S. Small Business Administration
Mail Code 6120
1441 L Street, N.W.
Washington, D.C. 20416

Official Business

Penalty for Private Use, $300

BULK RATE
POSTAGE & FEES PAID
U.S. Small Business Administration
Permit No. G-82